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Second Declaration of Dennis W. Carlton in Re: Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.: Before the Federal Communications Commission, CC Docket No. 97-211, March 19, 1998 (with H. Sider).

Pursuant to 47 C.F.R. §§ 1.743(c), 1.913(c), 5.54(c), the preceding document is a copy of the original signed affidavit, which was filed as an attachment to Exhibit 2 to the Form 490 applying for the Commission's consent to transfer control of Part 22 licenses held by Detroit SMSA Limited Partnership from Ameritech Corporation to SBC Communications Inc. That Form 490 was filed concurrently with this application.

Affidavit of
Richard Schmalensee and
William Taylor

AFFIDAVIT OF RICHARD SCHMALENSEE AND WILLIAM TAYLOR

COMMONWEALTH OF MASSACHUSETTS)
)
) SS:
)
COUNTY OF MIDDLESEX)

Richard Schmalensee and William Taylor, being duly sworn, depose and say:

Richard Schmalensee is the Gordon Y. Billard Professor of Economics and Management at the Massachusetts Institute of Technology (MIT), Interim Dean of the MIT Sloan School of Management, and Director of MIT's Center for Energy and Environmental Policy Research. He also is a Special Consultant to National Economic Research Associates, Inc. and has served as a Director of the Long Island Lighting Company, a Member of the EPA's Environmental Economics Advisory Committee, and Chairman of the EPA's Clean Air Act Compliance Analysis Council. He served as a Member of President Bush's Council of Economic Advisers with primary responsibility for domestic and regulatory policy, including environmental and telecommunications policy and for U.S. assistance to Central and Eastern Europe. He served for several years as a consultant to the Bureau of Economics of the Federal Trade Commission.

Dr. Schmalensee has done extensive research on aspects of industrial organization and antitrust policy, particularly nonprice competition and conditions of entry. He has also studied the telecommunications industry, the electric power sector and general issues of regulation and regulatory reform. He has testified in both federal and state courts, before several Congressional committees, and before the Federal Trade Commission, and he has served as a consultant on regulatory and competitive issues to numerous organizations in the United States and abroad.

He received his S.B. and Ph.D. degrees in economics from MIT and taught for some years at the University of California, San Diego. At MIT, he teaches graduate courses in

industrial organization, its applications to management decisions, government regulation and government/business relations. He has published over 60 articles in professional journals, including *The American Economic Review*, *The RAND Journal of Economics*, *The Harvard Law Review*, *The Journal of Econometrics*, *Public Utilities Fortnightly*, *Econometrica*, *The Journal of Law and Economics*, *The Journal of Industrial Economics*, *The Economic Journal*, *The Antitrust Law Journal*, *The International Journal of Industrial Organization*, *The Quarterly Journal of Economics*, and *The Journal of Economic Perspectives*.

He is the author of *The Economics of Advertising* and *The Control of Natural Monopolies* and co-author of *Markets for Power*. He is also co-editor of the *Handbook of Industrial Organization* and founding editor of the MIT Press Regulation of Economic Activity monograph series. He has served on the editorial boards of *The American Economic Review*, *Zeitschrift fur Nationalokonomie*, *The International Journal of Industrial Organization*, *The Journal of Economic Perspectives*, *Recherches Economiques de Louvain*, and *The Journal of Industrial Economics*. He has served on the Executive Committee of the American Economic Association and is a Fellow of the Econometric Society and the American Academy of Arts and Sciences.

William Taylor is a Senior Vice President of National Economic Research Associates, Inc. (NERA), head of its telecommunications economics practice and head of its Cambridge office. He received a B.A. degree in economics, magna cum laude, from Harvard College in 1968, a master's degree in statistics from the University of California at Berkeley in 1970, and a Ph.D. in Economics from Berkeley in 1974, specializing in industrial organization and econometrics. He has taught and published research in the areas of microeconomics, theoretical and applied econometrics, and telecommunications policy at academic institutions (including the economics departments of Cornell University, the Catholic University of Louvain in Belgium, and the Massachusetts Institute of Technology) and at research organizations in the telecommunications industry (including Bell Laboratories and Bell Communications Research, Inc.). He has participated in telecommunications regulatory proceedings before state public service commissions, the Federal Communications Commission, the Canadian Radio-Television and Telecommunications Commission and federal and state legislative bodies on

numerous topics in telecommunications economics including public interest assessments of mergers of major local, long distance and cable suppliers.

His articles have appeared in numerous telecommunications industry publications as well as *Econometrica*, the *American Economic Review*, the *International Economic Review*, the *Journal of Econometrics*, *Econometric Reviews*, the *Antitrust Law Journal*, *The Review of Industrial Organization*, and *The Encyclopedia of Statistical Sciences*. He has served as a referee for these journals (and others) and the National Science Foundation and has served as an Associate Editor of the *Journal of Econometrics*.

We have been asked by SBC Communications, Inc. ("SBC") and Ameritech Corporation ("Ameritech") to assess the likely effect of the proposed merger of SBC and Ameritech on consumers and competition in the telecommunications markets served by them. In the attached report, using conventional economic models and tools, we conclude that the merger can have no adverse effect on current competition in the telecommunications markets served by SBC and Ameritech and is unlikely to have any adverse effect on competition in those markets in the future. On the contrary, we conclude that by reducing costs and by facilitating entry by the combined firm into out-of-region local exchange markets—and reciprocally inducing entry of other ILECs into the local exchange markets of SBC and Ameritech—the merger is likely to provide substantial benefits to consumers.

Richard Schmalensee

William Taylor

Subscribed and sworn to before me this 21st day of July, 1998.

Notary Public

COMMENTS CONCERNING THE PROPOSED

SBC-AMERITECH MERGER

Report of Richard Schmalensee and William Taylor
National Economic Research Associates, Inc.
July 21, 1998

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REPORT OF RICHARD SCHMALENSEE

AND

WILLIAM TAYLOR

I. THE ECONOMIC FRAMEWORK FOR MERGER ANALYSIS

1. The Federal Communications Commission ("FCC" or "Commission") articulated its standards for merger review in its decisions in the SBC-Pacific Telesis and Bell Atlantic-NYNEX cases.[1] There, the Commission determined that to approve a proposed merger, it must find the transaction to be in the public interest, where the public interest standard encompasses the "broad aims" of the Communications Act, including, among other things, supporting a procompetitive, deregulatory national telecommunications policy framework. The Commission therefore considers the effect of the merger on competition, using, in part, the *Merger Guidelines* framework employed routinely by the U.S. Department of Justice and Federal Trade Commission to assess the welfare effects of proposed mergers and, in part, a framework specific to telecommunications markets including effects of regulation, high current concentration, rapid technological change and anticipated changes in market structure stemming from the implementation of the procompetitive requirements of the Telecommunications Act of 1996.[2]

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[1] In re *Applications of Pacific Telesis Group and SBC Communications, Inc.*, Memorandum Opinion and Order, Report No. LB-96-32, released January 31, 1997. In re *Applications of NYNEX Corp. And Bell Atlantic Corp Consent to Transfer Control of NYNEX and its Subsidiaries*, Memorandum Opinion and Order, ("Bell Atlantic-NYNEX Order"), CC Docket No. 97-286, released August 14, 1997.

[2] Bell Atlantic-NYNEX Order, ¶¶2-7.

2. Mitigating possible competitive harms from a merger are merger-specific efficiency gains that improve market performance, resulting in lower prices, improved service quality and the offering of new or enhanced services.[3] Likely sources of such gains include:

- economies of scale and scope which may result because of the increased size of the merged firm, through synergies in operations and management, or from expansion in output since markets available to the merged firm are larger than those served by the firms separately;

- more competitive prices, higher quality service and increases in output which may result from increased competitiveness in certain markets; and

- new products and services which may be developed in greater number and/or at greater speed because the return on product development may be higher in the merged firm due to improved incentives or scale economies.

3. The competitive analysis begins by identifying the relevant product and geographic markets in which the merging parties *currently* participate. Within those markets, it then measures the effect of the merger on market structure—the number and size distribution of firms competing in a market—as an indicator of the likely effect of the merger on competition in those markets. Economists consider both the level of and the change in market concentration. If the merger significantly increases concentration in a concentrated market, then the analyst must examine other factors affecting competition, including the ease of entry of new firms into the market, the pricing history of firms currently in the market, and the ease with which consumers can substitute away from the service in question in response to an increase in price. As described in Section III below, after divestiture of certain overlapping cellular properties, there will be no meaningful current, actual competition between operating entities of SBC and Ameritech in any product or geographic market, so these considerations do not apply.

4. A separate competitive analysis is applied to potential, rather than actual, competition, assessing the degree to which the merger is likely to eliminate an "actual potential" competitor whose likely entry in the future (whether perceived or not by current competitors) would reduce

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[3] *Ibid.*, ¶158

future market concentration and help to control future price increases in the market. The effects of potential competition are necessarily more speculative than those of actual competition; consequently, a finding that a merger is likely to have anticompetitive effects based purely on its effect on potential competition is relatively rare in antitrust enforcement.

5. In summary, if a proposed merger does not increase concentration in an already-concentrated market or eliminate a unique source of potential competition in such a market, the merger is treated as competitively benign. Such treatment accords with economic theory: if markets are unconcentrated or the merger does not substantially increase concentration in a market or significantly slow deconcentration and concomitant price decreases, then the merger is unlikely to increase the market power of the participants or the likelihood that the merged firm could raise prices or reduce the level of service quality.

6. After the required sale of overlapping cellular properties, SBC and Ameritech are not actual competitors of any consequence in any telecommunications market. Moreover, they are not significant potential competitors in any market because they possess no unique advantage in entering each other's markets compared with the many other potential entrants. On the contrary, SBC and Ameritech are disadvantaged with respect to entry compared with other telecommunications suppliers that already possess facilities, customers and brand name recognition in the markets to be entered. Thus, the merger poses no threat to actual or potential competition in any market.

7. On the contrary, the merger is likely to increase facilities-based local exchange competition both in-region and out-of-region. A consequence of the merger will be the implementation of a plan to enter local exchange markets in 30 major out-of-region MSAs initially in order to supply current large business customers with end-to-end services and subsequently to expand upon that footprint to serve other business and residential customers. If perceived as likely to be successful by its competitors, the plan should encourage reciprocal facilities-based local entry in the SBC-Ameritech region (and elsewhere) by other local exchange carriers also seeking to serve their large business customers wherever they do business.

II. BENEFITS FROM THE SBC-AMERITECH MERGER ARE LIKELY TO BE SUBSTANTIAL.

A. Cost Savings

8. The economics literature does not suggest that current Regional Holding Company (RHC) sizes exceed minimum efficient scale. Econometric evidence of scale economies among telecommunications firms much larger than SBC or Ameritech suggest positive scale economies with no evidence of diseconomies of scale. Nearly every other country (except Canada) provides local exchange service—prior to competition—through a single geographically integrated national supplier. This supports the observation that diseconomies of scale for local exchange service are unlikely at current firm sizes.

9. The large number of recent mergers and joint ventures throughout the telecommunications industry further suggests that current-sized firms do not exhaust the available economies of scale and scope. The primary examples of such mergers include AT&T-McCaw-TCG-TCI, MCI-WorldCom-MFS-Brooks Fiber-UUNet and Bell Atlantic-NYNEX. Joint ventures include AT&T WorldPartners and Deutsche Telekom-France Telecom-Sprint's Global One and Unisource.

10. Consider the pattern of these mergers and agreements. They appear not to be simple horizontal mergers in which the parties gain a larger share of a given market. Instead, they are either combinations of companies with similar services but which operate in different geographical areas, or they are combinations of companies which operate in overlapping areas but offer different services. The SBC-Ameritech merger is similar in that respect. It combines companies that serve different geographical areas, and, as explained below, the resulting greater return from new service development will enable them to expand service offerings in both areas.

11. There are several sources of cost savings that are likely to result from the merger:

- economies of scale: reduced unit costs by spreading fixed costs over a larger base of output; lower input prices through joint purchasing and volume discounts;

- economies of scope: reduced unit costs by supplying a full complement of telecommunications services, spreading R&D costs, for example, over all services that benefit from basic telecommunications research, spreading marketing costs of attracting customers over a wider range of services for those customers;

- net cost savings from integration: rationalization of duplicative expense and capital expenditures including (i) reduced staff expense for overlapping functions, (ii) redundant expenses for information systems and advertising, and (iii) reduced capital costs from additional volume discounts, reduced test labs and market trials.

12. As part of its pre-merger due diligence investigations, SBC developed estimates of the likely cost savings that would result from the merger, focusing on the savings from eliminating redundancies between the companies in three areas:

- Staff and Support redundancies: corporate oversight and governance,

- Systems and Infrastructure Support redundancies, and

- capital expenditure efficiencies: volume discounts, reduced redundancies in market and engineering trials.

By the third year after closing, annual cost savings stemming directly from the merger were estimated to include $1.2 billion in expense savings, $250 million in capital cost savings and $300 million from reduced costs and expanded revenue from the combined long distance companies, after they are permitted to enter the in-region interLATA market. In addition, application of best marketing practices between the Companies is estimated to increase revenue from new and existing services by $750 million per year.

13. In addition to these projected savings, there are likely to be additional cost savings that have not been quantified. Some of these additional savings would come from the following sources:

- The two companies can compare the cost, effectiveness, and quality of each other's processes. If SBC has a better practice for some process than Ameritech does, then Ameritech can deploy it, and vice versa. Each Company has an incentive to find the best match of practices because the resulting reductions in cost or increases in revenue will likely lead to higher profits. This reciprocal adoption of best practices is far more effective within a company than between two independent companies. Within a company, cooperation is greater, concerns about proprietary or competitively-sensitive

information are eliminated, and the information about each other's processes is more reliable. The result of this reciprocal adoption of best practices is lower costs and accelerated improvements in service quality to customers for both companies.[4]

- The merger would increase the effectiveness of investment in research and development by (i) joint management of R&D, (ii) spreading R&D costs over a larger base of products and services, and (iii) capturing the benefits of basic research in a larger company. In addition, the merger would improve the development of new services: supplying more of them, more rapidly and at lower cost.

- The merger would create a more effective entrant into the long distance market. The merged company's greater size will lead to lower costs and thus lower prices to toll customers. Further, the company could avoid redundant development and maintenance of operations systems that support the long distance business, including fraud detection systems, customer service support systems, and toll recording, rating, billing, and collection systems. Such operations systems are very expensive. For instance, MCI reportedly spends a billion dollars a year to develop software for new services like its "Friends and Family" service.[5] The company's improvements in its new service development process would similarly help its entry. As a more effective long distance competitor, it would be more likely to increase the competitiveness of the long distance market, reduce market prices, and stimulate innovation. Further, as a larger purchaser of interexchange carrier services for resale, it would be able to negotiate lower prices for its bulk transport purchases. This effect would put further downward pressure on long distance prices, to the benefit of consumers. Combining enhanced revenues, economies of scale, lower costs from higher-volume purchases of wholesale long distance services and avoidance of redundancy where the merged firm constructs facilities or uses existing facilities would amount to an additional $300 million annually.

B. Benefits from more effective competition

14. Large business customers with sophisticated network needs increasingly purchase from national or global suppliers. A regional supplier is disadvantaged in competition for local exchange or global services because large multi-location customers often prefer to deal with a single supplier. The merger would place the combined company at less of a disadvantage

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[4] While concerns about service quality sometimes arise in merger evaluations, they would be misplaced in the current proceeding. The SBC-Ameritech merger provides an opportunity to accelerate improvements in service quality.

[5] "Long Distance: Innovative MCI Unit Finds Culture Shock in Colorado Springs," *Wall Street Journal* (June 25, 1996), p. A1.

compared to competitors the size of AT&T and its WorldPartners alliance, the Deutsche Telekom-France Telecom-Sprint Global One, Unisource and whatever comes of the BT-MCI "Concert" joint venture after the MCI-WorldCom merger is settled. Other comparable multinational telecommunications firms include Nippon Telephone and Telegraph, France Telecom, British Telecom and Telecom Italia. Adding another potential supplier to this concentrated market has obvious procompetitive benefits in the market serving large business customers. In addition, there will be long-term benefits from enhanced competitiveness among national and global suppliers that will accrue even to customers that only purchase local exchange service, because SBC and Ameritech will be able to retain contribution from high-volume customers that they would otherwise have lost as stand-alone regional telephone companies.

15. The merger also makes possible the National-Local strategy of supplying local exchange services on a facilities basis to the Company's largest business customers in as many of their locations as possible. As described in Mr. Kahan's affidavit, the Plan contemplates first providing a single facilities-based source for communications services for the 1000 largest companies in the U.S., customers who typically demand a sophisticated array of network services designed individually to supply the mix of services (voice, data) required at the customer's worldwide locations. Second, the Plan expands facilities from that base to serve smaller business and residential customers, and third, the Company proposes to build a new integrated packet-switched network to provide high-speed data services along with Internet access capability to both business and residential customers.

16. The Plan promises additional facilities-based local exchange competition from what has heretofore been regarded as an unlikely source: entry by out-of-region ILECs.[6] Such a strategy will enable the combined companies to compete in local exchange markets against other companies—mainly IXCs—that currently serve their customers on a national and global basis.

[6] Out-of-region ILECs have generally been discounted as likely potential entrants because they have no existing customer base from which to expand (unlike IXCs, CAPs, and cable companies), no facilities to share with existing services and little brand equity out-of-region.

In addition, entry in this particular form will motivate the affected ILECs (e.g., Bell Atlantic, BellSouth, US WEST) to retaliate by competing initially for large business customers in SBC-Ameritech territory. However, as described in Dr. Carlton's affidavit, execution of the Plan is contingent on the merger. The ability to undertake and manage the massive expansion required to follow a significant fraction of the demand of the largest business customers depends very much on size. Managing a strategy of entering geographically-dispersed markets initially to serve a relatively narrow base of customers requires a large, flexible pool of management and employee skills if such entry is to be cost-effective. A substantial base of current customers and revenues is necessary to maintain earnings growth and spread risk while following customers into out-of-region local markets. No other ILEC or CLEC has announced an out-of-region local competition initiative of comparable scope, and, in the U.S., the only carriers currently competing on a national-local basis are the vertically-integrated IXCs (AT&T-TCG-TCI and MCI-WorldCom-MFS-UUNet-Brooks Fiber).

17. Of the merger cost savings, some will go to stockholders. The remainder will likely be passed through to consumers in the form of improved services, lower prices, more rapid introduction and dissemination of new services, and additional options and packages of services as competitive forces require. It would be unusual for a firm not to use some of its cost reductions to expand its markets, so that the sum of the benefits to stockholders and consumers will likely exceed the merging companies' own cost savings. The reason is that one firm's price reductions or quality improvements will tend to force competitors to lower their prices or improve their products as well. Consequently, all consumers in those markets benefit, not just the customers of the merging companies. This effect can be especially magnified in markets such as interLATA long distance where the merging companies have small market shares. A price reduction for their small fraction of industry output can affect prices in the whole market, greatly expanding the aggregate benefit to consumers.

C. Less costly and more rapid introduction of new technologies and services

18. The merger will stimulate less costly and more rapid development of new telecommunications products and services because the return to the introduction of new products and services will be higher in the merged firm. The companies will experience (i) a reduction in risk from increased size, (ii) savings in joint purchases of capital equipment, (iii) sharing costs of technical and marketing trials, and (iv) elimination of redundant support systems. The merger will permit the expanded firm to purchase a more diverse mix of technologies and greater use of different suppliers without sacrificing the financial benefits of volume purchasing.

19. First consider the sources of cost savings. Currently, both companies have new service development efforts, which consist of many complex and costly steps. At all stages of the process, cost savings can occur by eliminating duplicative efforts and exploiting economies of scale, including lower equipment prices from vendors who offer volume discounts. Another benefit from the greater size and diversity of the merged companies' markets is the potential reduction in risk of new service offerings. The success of new services is always uncertain. Much of the merger savings are likely to occur in the fixed initial costs of new service development. For a larger firm, the fixed costs are smaller relative to the variable costs, so, if market demand for a new service proves to be disappointing, less investment is at risk per unit of output. Further, the merged company's larger size makes it more economical to experiment with different services, features, technologies, and vendor equipment, without sacrificing substantial volume purchases.

20. Second, consider the implications for the pace and intensity of new service introductions. The merged company's new service development efforts will be more profitable than they would be for the two separate companies. After the merger, the new company will be

significantly larger than either SBC or Ameritech individually.[7] Because most of the new service development costs are insensitive to the scale of deployment, for any given service, the return on a new service development effort will be substantially greater than it would be for the two individual companies. This greater profitability of its new service development efforts will stimulate the merged firm to accelerate development of each potential service and to develop more services. In its decision in the Bell Atlantic–NYNEX merger, the FCC expressed the concern that elimination of duplicate R&D would also eliminate a source of non-price competition that could give customers added service variety and quality[8]. That concern is largely absent in the current case because while SBC has a research division, Technology Resources, Inc. ("TRI"), Ameritech has no equivalent organization, and the firms do not compete through research and development efforts.

21. A more profitable new service development program would benefit consumers directly. Any new service generates consumer surplus as it more effectively meets customers' needs than existing services did, and consumer surplus gains from new services are surprisingly large.[9] The communications market is more dynamic than most other markets, with rapid changes in the technology, market needs, and competitive alternatives. The potential gains to the merging companies and to consumers from improved incentives to develop new services are much more important than they would be in most other industries. The more efficient service development program associated with the merger would also enable the Company to make a more effective challenge to the market dominance and high profit margins of the big three long distance carriers.

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[7] 1997 revenues were $25 and $16 billion for SBC and Ameritech, respectively, according to their Annual Reports.

[8] Bell Atlantic-NYNEX Order, ¶ 171.

[9] For instance, according to one estimate, the introduction of voice mail service increased consumer welfare by $1.2 billion in 1994. See J.A. Hausman and T.J. Tardiff, "Valuation of New Services in Telecommunications" (1995).

D. International and Global Opportunities

22. As their major customers expand across national boundaries and continents, telecommunications companies are responding by consolidating through mergers, alliances and joint ventures. Examples include (i) AT&T's "WorldPartners" alliance between AT&T and 17 foreign carriers, (ii) Sprint's "GlobalOne" alliance with Deutsche Telekom and France Telecom, (iii) Unisource—an alliance among 4 European PTTs and (iv) Cable & Wireless, which has ownership interests in various foreign local, long distance and wireless companies and which recently announced its acquisition of MCI's global Internet business. Through these consolidations, telecommunications companies can offer to supply multinational customers with end-to-end trans-border services, which is exceedingly valuable to many large business customers whose networks require consistent standards and single points of contact in case of failure. As seen in the case for the National-Local Plan, following multinational customers to their many locations is an attractive business plan for companies with sufficient financial and managerial resources to undertake the required investment and expansion. Regional carriers will increasingly find themselves at a disadvantage in competing for national and multinational accounts, and the proportion of traffic in such accounts is growing rapidly.

23. While SBC's incentive to expand globally into foreign local markets is primarily to serve its multinational business customers, the benefits from that expansion are not confined to large business customers. As SBC's network expands geographically and technologically through the three portions of its National-Local plan to keep pace with those of its global competitors, small business and residential customers who depend on SBC's facilities for retail services they buy from SBC or resold services they buy from others will benefit from the increased number and functionality of the services they receive and the prices they pay.

E. Summary of likely benefits from the merger.

24. Likely efficiency gains from the merger include a sizable reduction in total corporate overhead expenses and capital expenditures through a rationalization of redundant support activities. Additional cost reductions and more rapid improvements in service quality can be realized through the mutual adoption of each company's best practices. Increased profitability

from a wider base of support for research and new service development would bring more new services to customers more rapidly. Finally, local exchange customers benefit from the enhanced ability of the merged firm to compete with national and global suppliers in local exchange and long distance markets.

III. THE SBC-AMERITECH MERGER WILL NOT ELIMINATE ACTUAL COMPETITION IN ANY ECONOMIC MARKET.

25. Ameritech and SBC currently supply traditional telecommunications services to business and residential customers in distinct geographic regions. Ameritech serves portions of the states of Illinois, Michigan, Indiana, Wisconsin and Ohio, while SBC's territory includes parts of Missouri, Arkansas, Oklahoma, Texas, Kansas, California and Nevada. Within their respective service territories, Ameritech and SBC provide both wireline and wireless telecommunications services. Wireline telephone services include customer access, local usage, vertical services (*e.g.,* call waiting, call forwarding), business services (*e.g.,* Centrex services), private line, public (coin) telephone, intraLATA long distance services, and exchange access services. Prices and terms and conditions of most wireline services are regulated by individual state public utility commissions and by the FCC. Wireless offerings include cellular, PCS and paging services, whose prices and terms and conditions are generally not controlled by regulatory agencies. Outside their service territories, both companies have begun to resell long distance services, and both companies own wireless (cellular or PCS) properties.

26. In its Bell Atlantic-NYNEX Order, the Commission began its analysis by identifying the relevant product and geographic markets within which it then appraised the effects of the merger on actual and potential competition. Based on the demand substitution approach to product market definition used by the *Merger Guidelines*, the Commission focussed on three relevant markets: local exchange and exchange access services, long distance services, and bundles of those services. To that collection, we would tentatively add a fourth—wireless services—that were unnecessary to consider in the Bell Atlantic-NYNEX merger because the merging companies already provided wireless services through a joint venture. Our treatment of wireless services as a separate market is tentative because—as the Commission itself has

noted—wireless services, particularly PCS, have the potential to become substitutes for wireline local exchange services as prices of wireless services fall.[10]

27. The Commission found that the relevant geographic markets in the Bell Atlantic-NYNEX case were areas "in which all customers in that area will likely face the same competitive alternatives for a product" and identified LATA 132 as a relevant market of particular concern.[11] In the current case, the only geographic markets in which the merger could have any effect on actual or potential competition are the St. Louis and Chicago LATAs where SBC and Ameritech own competing cellular systems and are respectively the incumbent wireline carriers (i.e., SBC is the ILEC in St. Louis and Ameritech is the ILEC in Chicago).[12] In addition, the FCC identified three classes of customers for which it performed separate analyses in the Bell Atlantic-NYNEX Order: residential and small business customers, medium-size businesses and large business/government users.[13]

28. The merger of SBC and Ameritech will not combine any entities that compete to any meaningful extent with one another in any relevant geographic market for any product or service. The wireline local exchange companies of SBC and Ameritech currently serve discrete territories in their respective states. Their territories do not overlap anywhere and they provide

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[10] "PCS providers appear to be positioning their service offerings to become competitive with wireline service, but they are still in the process of making the transition 'from a complementary telecommunications service to a competitive equivalent to wireline services.'" *In the Matter of Application by BellSouth Corporation, et al. Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Louisiana*, Memorandum Opinion and Order (CC Docket No. 97-231) released February 4, 1998, at ¶73.

[11] Bell Atlantic-NYNEX Order at ¶54.

[12] There are a dozen other MSAs and RSAs in Chicago, St. Louis and central Illinois in which SBC and Ameritech cellular license areas overlap. FCC Rules require the removal of all of these overlaps.

[13] *Ibid.*, at ¶53.

local exchange services in distinct geographic markets.[14] There are geographic markets in which SBC and Ameritech currently provide cellular services which overlap in Chicago, St. Louis and central Illinois, but FCC rules require that such properties be sold to unrelated purchasers. Thus, the merger will not combine any entities which currently compete in a relevant geographic and product or service market. Further, Ameritech's cellular service currently competes with SBC's Cellular One service in St. Louis and has contemplated offering resold wireline local exchange services to its cellular customers in St. Louis. Once one or the other cellular asset is sold, however, an unrelated entity will own and manage a cellular franchise and whatever local exchange business it can profitably supply in St. Louis. However effective cellular companies may be as competitors to the wireline local exchange company, the merger—conditioned on the sale of the competing cellular carrier—will not diminish that source of competition.

29. Although SBC and Ameritech both offer long distance services out-of-region (and thus nominally could compete in some out-of-region states), the effect of the merger on competition in the national long distance market is imperceptible for two reasons. First, SBC and Ameritech have almost negligible market presence as long distance carriers in out-of-region states, competing as two small resellers among several hundred resellers in a national market dominated by four nationwide facilities-based firms (of which two are in the process of merging).[15] Second, until SBC and Ameritech are permitted to provide in-region long distance service, their primary incentive to supply long distance services out-of-region as a reseller is to provide full service to their in-region calling card customers when they travel out-of-region.

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[14] Ameritech served out-of-region locations for one large business customer on a pilot basis, comprising a small number of resold lines in California, New York and Texas. (Weller Affidavit, ¶ 32) While it has not pursued similar arrangements with other customers, it continues to supply service to the original customer. Because Ameritech apparently abandoned plans to roll out the service to other such customers and because those customers already have alternatives to ILEC services, the effect of the merger on competition would be negligible.

[15] SBC provides cellular long distance in Illinois and Indiana where Ameritech cannot while Ameritech provides cellular long distance in Missouri where SBC cannot.

Thus, there is no economic sense in which SBC and Ameritech compete for long distance customers or calls originating (for example) in South Carolina despite the fact that they both could offer service there.

30. In summary, the merger would have no effect on concentration in any relevant market and would not be likely to create or enhance market power, slow its decline or facilitate its exercise. Although some of the markets in question may be highly concentrated, the fact that no actual competitor would be removed from any market makes the merger benign with respect to possible increases in market power of actual competitors. In addition, the fact that a market is currently concentrated does not imply that the usefulness of the *Merger Guidelines* is somehow diminished or that future market power will necessarily be a concern. It is well-known that in dynamic markets such as telecommunications in which market position has been created and maintained by regulation, current market concentration is a poor predictor of future market power.[16]

IV. THE MERGER OF SBC AND AMERITECH WOULD NOT SUBSTANTIALLY REDUCE ACTUAL POTENTIAL COMPETITION.

31. The proposed merger also poses no threat to potential competition in any relevant market. As described above, an analysis of the effect of the merger on potential competition assesses both firms that serve the markets in question and firms that are likely to enter those markets in the future. An *actual* potential competitor is a firm that is likely to enter the market in the future. A merger that eliminates an actual potential competitor is thought to result in competitive harm when (i) the target market is highly concentrated, (ii) there are few other equally significant potential entrants, (iii) entry was reasonably certain but for the merger, (iv) the acquiring firm had alternative means of entry, and (v) those alternative forms of entry

[16] See W.M. Landes and R.A. Posner, "Market Power in Antitrust Cases," *Harvard Law Review*, Vol. 94 (March 1981), pp. 975-976, for an analysis of the effect of regulation on the relationship between market concentration and market power.

would likely have produced deconcentration or other procompetitive effects in the market.[17] Applying these standards to the Bell Atlantic-NYNEX merger, the Commission found that the merger would eliminate one of four potential significant entrants and one that it found to be the second choice alternative for a significant number of customers. On those grounds, it determined that additional conditions were necessary—increasing the ability of competitors to enter and expand quickly—in order that the Bell Atlantic-NYNEX merger not increase the risk of unilateral exercise of market power or coordinated interaction.[18]

32. Application of those standards to the current merger produces the opposite result. Absent the merger, neither SBC nor Ameritech would have entered Chicago or St. Louis on a facilities basis to provide local exchange services.[19] Moreover, as noted, the fact that one of the cellular businesses in both St. Louis and Chicago will be sold to a third party is dispositive because the sale will preserve whatever entry potential is associated with these businesses.

A. SBC entry into Chicago and Ameritech entry into St. Louis was unlikely.

33. Absent the merger, (i) SBC had no plans to enter Ameritech markets and (ii) Ameritech's possible entry into one SBC market (St. Louis) is not of significant competitive concern. Before the merger decision, SBC had no plans to enter any of Ameritech's local exchange markets. According to Mr. Sigman's affidavit, in late 1995, SBC began to consider the possibility of offering resold local exchange service to Cellular One customers out-of-region. The intention was to attract new cellular customers and reduce churn by offering a

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[17] Bell Atlantic-NYNEX Order at ¶138. See also Section 4 of the 1984 *Merger Guidelines*. These policies regarding the effects on potential competition were specifically cited as remaining in effect in the *Statement Accompanying Release of the Revised Merger Guidelines*, April 2, 1992, at 3.

[18] Bell Atlantic-NYNEX Order at ¶108 and ¶123.

[19] SBC had rejected local exchange entry in Chicago, while Ameritech's cellular unit was considering entry in St. Louis on a resale basis only. See the Affidavits of Paul G. Osland and Stanley T. Sigman.

packaged service and to spread customer acquisition costs over a broader base of services. In early 1997, Cellular One entered the Rochester, New York local exchange market as a trial, marketing resold local exchange service to its cellular customers. Simultaneously, SBC Wireless studied the possibility of local exchange entry in other out-of-region markets including Chicago. Certification from the Illinois Commerce Commission was obtained but no interconnection negotiations were undertaken with Ameritech and no firm plans were made for entry. For a number of reasons, the Rochester experiment subsequently proved to be unsuccessful, and by the end of 1997, SBC had decided not to pursue additional customers in Rochester or to attempt local exchange entry in any other out-of-region market including Chicago.[20]

34. Thus, instead of expanding from its wireless platforms, SBC, through its National-Local strategy, plans to leverage from its existing relationships with in-region large business customers. As discussed above, the merger is an important prerequisite to the implementation of that strategy, a strategy which, if successful, will supply additional local exchange competition outside the SBC-Ameritech region and subsequently induce additional local competition inside the SBC-Ameritech region, as other ILECs respond by offering similar packages to their national and multinational business customers.

35. For its part, Ameritech also considered out-of-region entry into a local exchange market from its cellular platform. According to Mr. Osland's affidavit, Ameritech Cellular began to reassess its strategy in St. Louis in 1997 as AT&T, Sprint PCS and Nextel services were introduced to the market. When AT&T, Sprint and MCI filed for certification as local carriers in St. Louis, Ameritech Cellular was prompted to consider a bundled offering (combining cellular and resold SBC local exchange service) to compete against the anticipated bundled services of these new wireless companies. Ameritech had no local exchange facilities in St. Louis and had no intention to construct facilities in the St. Louis region or to use its wireline facilities in Southern Illinois to serve its local exchange customers. The service was targeted to

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[20] Affidavit of Stanley T. Sigman, ¶¶ 17-18.

existing residential cellular subscribers, pricing packages were designed, and, in January 1998, Ameritech Cellular began an employee user trial with about 390 employee-customers and their families. The trial proved not to be wholly successful for financial, technical and operational reasons, and the project is currently "on hold."[21] Of course, regardless of Ameritech's plans or intentions, divestiture of either cellular property in St. Louis to satisfy the FCC's cellular license ownership rules means that the merger of SBC and Ameritech will not diminish local exchange competition in St. Louis. Whatever success Ameritech Cellular might have had in marketing resold local and long distance services to its cellular customers could be achieved by its (or SBC Wireless') successor, so that the merger will not reduce the possibility of local exchange competition in St. Louis from a wireless platform.

36. These histories contrast sharply with the conclusions the Commission reached regarding the likelihood of Bell Atlantic entry into LATA 132:

> We find that Bell Atlantic is both a precluded competitor and among the most significant market participants both in the market for local exchange and exchange access, and in the market for bundled local exchange, exchange access, and long distance services for the mass market in LATA 132 and the New York metropolitan area. The basis for this conclusion is that Bell Atlantic was actively seeking to enter those markets using wireline technology and has the capabilities necessary to have an effect on those markets...Bell Atlantic was, until merger discussions were well underway, engaged in planning out-of-region entry into local exchange, exchange access, and long distance services in a number of locations in the NYNEX region, most notably LATA 132. The extent of planning reflected in the documents persuades us that Bell Atlantic would likely have entered LATA 132.[22]

SBC had no specific plans to enter the Chicago local exchange market by reselling Ameritech local exchange service to its cellular customers because that strategy appeared to be unsuccessful in its Rochester trial. SBC had no other plans to provide local exchange services out-of-region. Similarly, Ameritech Cellular's employee trial of the same strategy in St. Louis

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[21] Affidavit of Paul G. Osland, ¶¶ 9-13.

[22] Bell Atlantic-NYNEX Order at ¶73.

revealed technical and financial difficulties, and the project has been suspended. Unlike the Bell Atlantic case, neither SBC nor Ameritech was "until merger discussions were well underway, engaged in planning out-of-region entry into local exchange, exchange access and long distance services" in Chicago or St. Louis "using wireline technology," and, had they actually offered to resell ILEC local service to all of their residential cellular customers, it would have been unlikely to have had a significant effect on the Chicago or St. Louis local exchange markets. Finally, regardless of the Companies' plans, the reciprocal divestiture of a cellular property in both Chicago and St. Louis ensures that the merger will not reduce local exchange competition from a wireless platform. Moreover, other wireless service providers in St. Louis are in at least as good a position as Ameritech to provide local exchange services. AT&T, for example, with its large interexchange customer base in St. Louis is in a position to bundle local exchange and long distance services with its wireless service offerings.

B. Entry into local exchange markets is easier than in the past.

37. Over two years have passed since Bell Atlantic-NYNEX filed its Application for Transfer of Control, and during that period, great strides have been made to improve the implementation of the resale, unbundling and interconnection provisions of the Act. These provisions require incumbent LECs to resell all retail services at an avoided cost-based discount and offer unbundled network elements and interconnection to competitors at cost-based rates.[23] Entry and rapid expansion of local exchange competitors has benefited from massive investment in facilities, systems, and training by the ILECs and from industry-wide experience with the procedures. The availability of resale and unbundled elements at cost-based prices eliminates advantages of incumbency and increases the speed with which new entrants can expand and offer facility-based local exchange services to their customers.

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[23] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Report and Order, 11 FCC Rcd 15499 (1996) *vacated in part and aff'd in part sub nom. Iowa Utilities Board*; *Order on Reconsideration*, 11 FCC Rcd 13042 (1996); *Third Order on Reconsideration and Further Notice of Proposed Rulemaking*, CC Docket Nos. 96-98, 95-

(continued...)

38. According to Mr. Carter's Affidavit, since 1996, SBC has spent more than $1 billion and assigned 3,300 employees to develop and expand its wholesale businesses. As described in Mr. Appenzeller's Affidavit, Ameritech's efforts have been comparable. Of course, investment and labor are inputs, not outputs, and a better measure of the reduction in entry barriers and increase in competitors' ability to enter local telecommunications markets in SBC and Ameritech territory is the result of that process.

39. As an entry strategy, resale entails the least risk and the smallest investment in sunk costs. It may be the ideal strategy for an entrant that already supplies one service to a group of customers to expand into packaged services, improving its offering to its customers and possibly spreading customer acquisition costs over a wider base of service revenue. Resale of local exchange service is particularly attractive because under the Telecommunications Act, resold local exchange services are priced at an avoided-cost discount off of the price of the retail service. Where retail local exchange services are priced below cost, resale—at an avoided cost discount below the below-cost retail price—may be the least expensive form of entry. CLECs have responded: as of the end of May 1998, SBC resold approximately 630,000 lines compared with 635,000 for Ameritech.

40. The second form of entry into local exchange markets is by combining unbundled network elements ("UNEs") purchased from the ILEC or partly or wholly supplied by the entrant. Using this method, some CLECs have constructed collocation facilities, deployed switches, gained access to end links or local loops, received NXX code assignments, ported numbers and negotiated interconnection arrangements. According to information provided by SBC and Ameritech, over 50 local exchange competitors have purchased more than 150,000 unbundled loops, 300 unbundled switch ports and 500,000 interconnection trunks. SBC and

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185, FCC 97-295 (rel. Aug. 18, 1997); *Iowa Utilities Board* v. FCC, Nos. 96-3321, et al. (8th Cir. July 18, 1997), at Sections VII and VIII.

Ameritech have negotiated approximately 500 interconnection and resale agreements and currently have approximately 1000 collocation arrangements with an additional 700 pending.

41. One final measure of the reduction in barriers to entry into local exchange markets is the observation that in the first quarter of 1998, net business line additions for CLECs as a group exceeded those of the Bell Operating Companies as a group for the first time. From this landmark event, one market analyst concluded that

> the combination of access to low cost capital coupled with a clear regulatory and public policy initiative toward opening up local markets has allowed the CLECs as a group to achieve in less than two years after the Telecom Act what it took MCI and other alternative long distance carriers over 10 years to achieve during the 1970s and 1980s.[24]

It should come as no surprise that the ability of CLECs to enter SBC and Ameritech local exchange markets in 1998 exceeds their ability to enter Bell Atlantic-NYNEX local exchange markets in 1996.

C. SBC and Ameritech have no unique advantages over other possible entrants in each other's local exchange markets.

42. Finally, it is generally recognized in antitrust economics that if three or more firms possess the same or comparable advantages as possible entrants, the merger would be unlikely to have adverse competitive effects. In general, Ameritech has no particular advantages over other potential competitors in St. Louis local exchange markets; similarly SBC has no unique advantage over other possible entrants in Chicago. Unlike Bell Atlantic's possible entry into LATA 132, proximity is no particular advantage or inducement to enter. SBC and Ameritech share only one border (Illinois with Missouri), and St. Louis is the only major market along that border. Unlike the Bell Atlantic case, Ameritech's wireline business does not undertake

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[24] J. Grubman, Smith Barney, "Review of First Quarter CLEC and RBOC Line Growth," May 6, 1998.

extensive marketing using the same media as SBC uses to reach its customers in St. Louis.[25] In addition, in both states there is substantial facilities-based competition with both companies' services from other entrants.

43. In St. Louis, as of the summer of 1998, there are 5 local competitors operating about 16 switches. In Chicago, there are at least 13 local competitors operating 43 switches. Across the regions, competitors have installed over 500 local switches in SBC's territory and more than 150 in Ameritech's. Transport is supplied competitively as well. CLECs installed fiber networks exceed 6,500 route miles in SBC's territory and 5,000 in Ameritech's. In St. Louis, MCI-MFS-WorldCom has operated a local network since 1995. TCG serves the entire St. Louis metropolitan area and smaller local networks are operated by Digital Teleport and Intermedia. In Chicago, MCI-MFS-WorldCom, AT&T-TCG-TCI and NextLink all operate their own local networks, which, together with networks planned or under construction by smaller CLECs account for about 648 route miles of fiber.

44. More important, SBC and Ameritech lack the clear advantages of some other formidable potential entrants into local exchange telephone service. IXCs, CAPs and cable companies currently have existing wireline networks, customer relationships and brand recognition in the geographic markets in question. These firms have already incurred the sunk costs of building networks in the region and would benefit from expanding the services offered to their current customers (toll, carrier access and cable television) to include local exchange telephony. Although SBC and Ameritech have cellular facilities and customers in each others' territories, their trials of reselling wireline local exchange service from a wireless base have not been entirely successful. However, even if such entry were likely, the required divestiture of competing wireless franchises ensures that the merger will not reduce the possible effect of this type of entry.

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[25] Bell Atlantic-NYNEX Order at ¶106.

45. By supplying local service, the IXCs, CAPs and cable companies can augment their current offerings to provide one-stop shopping, making it more likely that they will keep their current toll, access and cable customers. Such incremental expansion into local service leverages their already-established brand recognition, reputation, sales relationships and network infrastructure. In the coming convergence of telecommunications technologies and firms, it is more rational to build out from existing lines of business, infrastructures, and customer bases than to enter a new competitive market starting from scratch. The recent announcement of the AT&T-TCI merger reaffirmed this view:

> AT&T Consumer Services will provide the broadest set of consumer communications services – including local, long distance, wireless and international communications, cable television, dial-up and high-speed Internet access services – all under the AT&T brand name...AT&T Consumer Services will own and operate the nation's most extensive, broadband local network platform. Following the merger, the new unit intends to significantly accelerate the upgrading of its cable infrastructure, enabling it to begin providing digital telephony and data services to consumers by the end of 1999, in addition to digital video services.[26]

which is echoed by others in the industry:

> WorldCom, Inc. and MCI Communications Corporation announced today a merger agreement creating a fully integrated communications company that will provide a complete range of local, long distance, Internet and international communications services. The merger creates a new era communications company best positioned to take advantage of growth opportunities in the $670 billion global telecommunications market.[27]

46. In sharp contrast to out-of-region RHCs, these firms have clearly expressed and acted upon their intentions to enter local exchange markets in SBC and Ameritech territories. These CLECs possess networks, customers and brand recognition throughout the SBC and Ameritech

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[26] "AT&T, TCI to merge, create new AT&T consumer services unit," AT&T Press Release, June 24, 1998.

[27] "WorldCom And MCI Announce $37 Billion Merger," MCI Press Release, November 10, 1997.

regions that can be expanded to provide local exchange service, particularly in concert with unbundled links and ports supplied by SBC and Ameritech. Every local exchange customer has a business relationship with an IXC and about 65 percent of households have a relationship with a cable company.

47. Without an effective platform of facilities or customers in the target area, there is no economic reason to expect an RHC (or any other ILEC) to be particularly likely to enter another ILEC's local exchange mass markets at this time or in the relevant future. Market prices for residential local exchange services are not attractive for the ILECs, relative to margins in other telecommunications markets, notably long distance. Further, neither SBC nor Ameritech has significant brand identification or market presence as a local exchange carrier in the other's mass markets, and neither can complement its existing product line in its own market by supplying local exchange services in the other's market. Neither has any existing wireline network infrastructure in the other's territory from which complementary telecommunications services (e.g., long distance or video programming) could be supplied. As discussed, their efforts to resell ILEC local exchange service to their cellular subscribers were not completely successful.[28]

1. IXCs

48. The FCC determined in connection with the Bell Atlantic-NYNEX merger that the three major IXCs—AT&T, MCI and Sprint—were among the most significant participants in the local exchange and exchange access markets. It found that each of these three firms had the capabilities and incentives to acquire rapidly a critical mass of customers.[29] The FCC's determinations in this regard were based on national data, and there is no reason why those conclusions would not be true in Chicago, St. Louis and other areas in SBC's and Ameritech's

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[28] But even if they were successful, the merger—and consequent divestiture of the cellular properties—would not reduce the degree of local exchange competition provided by the cellular licenses.

[29] Bell Atlantic-NYNEX Order at ¶82.

regions. Indeed, events since the FCC ruled on the Bell Atlantic-NYNEX merger strengthen those finding.

49. With its acquisitions of TCG and TCI, AT&T has embarked upon an aggressive strategy of local exchange entry. At recent Senate hearings, AT&T's current Chairman and CEO C. Michael Armstrong testified that the TCI merger

> ...will enable consumers to make phone calls over cable, thereby promising an alternative to the Bell monopolies in areas TCI reaches.[30]

50. As a result of its acquisitions, AT&T has greatly expanded its reach into the local exchange markets for business and residential customers. According to its 1997 Investor Fact Sheet, TCG's network in 1997 included more than 9,600 route miles in 82 major metropolitan markets across the U.S., serving predominantly business customers. For residential customers, TCI connects to approximately 10 percent of the households in the U.S. .and passes an additional 7 percent. Prior to these acquisitions, AT&T had announced plans in April of 1996 to offer business services from five different CAPs, under its own brand name, in 70 cities across the country:

> The CAP agreements will serve notice on the Bell regional holding companies...that AT&T has alternatives for entry into the local services market.[31]

These CAPs are Time Warner Communications, Hyperion Telecommunications, IntelCom Group, WorldCom-Brooks Fiber, and e. spire.[32] Today, these CAPs have multiple facilities throughout the SBC-Ameritech regions: for example, Time Warner has 4 switches each in SBC and Ameritech states, while Hyperion and e.spire have 2 and 14 switches respectively in SBC's region.

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[30] "Panel Discusses AT&T, TCI Merger," Associated Press, July 7, 1998.

[31] "AT&T Unveils Pacts with 5 CAPs as Signal to LECs," *Telecommunication Reports Daily*, April 11,1996.

51. AT&T has competitive facilities in SBC's region in Los Angeles, San Francisco, St. Louis and in Ameritech's region in Chicago, Indianapolis, Detroit, Cleveland, and Milwaukee. Its purchase of TCG gives it a competitive advantage in serving the business market as it now owns all of TCG's switches, competitive facilities and collocation cages, including 90 local switches in SBC territory and 68 in the Ameritech states. TCG serves the entire St. Louis metropolitan area with its own network, while AT&T operates its own network in Chicago as well. Similarly, AT&T's proposed merger with TCI provides a facilities basis on which to compete for residential customers. It intends to upgrade TCI's cable facilities at a cost of $300-500 per household on a pilot basis in 1999 with full deployment in 2000.[33] With the addition of TCI, AT&T will reach over 180,000 cable subscribers in St. Louis and its Missouri suburbs and over a million subscribers in the Chicago area. AT&T also has PCS subscribers in Ameritech and SBC regions.

52. In addition to its network, AT&T possesses a brand name reinforced by years of massive national and world-wide advertising which it will be able to use in bundling facilities-based local, long distance Internet, cellular and cable services together to create an attractive package for customers. As a likely potential entrant, AT&T-TCI-TCG has experience comparable to that of SBC or Ameritech in providing local telecommunications networks and has the advantage of being able to resell any ILEC product that might give the ILEC a competitive advantage. In addition, AT&T-TCG-TCI has the ability to bundle facilities-based long distance service with local, cable and Internet services which neither SBC nor Ameritech can match. In sum, AT&T is clearly a formidable competitor to SBC and Ameritech. It is both more likely to enter the Chicago and St. Louis markets than SBC and Ameritech respectively and has more unique advantages in serving local exchange markets than out-of-region ILECs.

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[32] "AT&T - 70 Cities Pact -2-: For Local Carrier Competition," *Dow Jones News Service*, April 11, 1996.

53. MCI-WorldCom is the second-largest IXC and the largest CLEC. It has facilities in 100 markets,[34] 82 local exchange switches in SBC's region, and 33 in Ameritech's region. In addition, MCI-WorldCom has facilities in 53 foreign cities.[35] Like AT&T, it has a large customer base and brand name recognition based on massive advertising and marketing expenditures to support its long distance business. With its proposed alliance with WorldCom, MCI becomes a formidable competitor for bundled local, long distance and Internet services. Because of the company's size and reach, it can supply local and global telecommunications services to customers across the country and around the world. MCI-WorldCom purchases interconnection trunks and business and residential lines in every state in SBC and Ameritech territory.

54. MCI offers its 'MCI One' package, which combines communications services ranging from Internet access and cellular calling to long distance on one bill. Initially the package did not include local service and was intended for consumers and small businesses.[36] MCI is now in a position to offer such services in SBC's territory in St. Louis. MCI-WorldCom has a large customer base and substantial facilities in St. Louis. In addition, MFS, one of WorldCom's CLEC operations, serves large business customers in St. Louis through its optical fiber network.

55. Sprint Corp. offers local telephone service in 42 states and plans to provide bundled services, including wireless telephone communications, local telephone services, and cable

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[33] Prepared Testimony of C. Michael Armstrong. Chairman and CEO, AT&T Corp. before the Senate Committee on Judiciary Antitrust, Business Rights and Competition Subcommittees, July 7, 1998.

[34] WorldCom Press Release, *WorldCom and MCI announce $37 Billion Merger: $51 in WorldCom Stock per Share: New Era Communications Company Targets Biggest Growth Opportunities*, Nov. 10, 1997.

[35] *Op. Cit.,* WorldCom Press Release, Nov. 10, 1997.

[36] N. Louth, "MCI To Unveil One-Stop Package For Phone Services," *Reuters Business Report*, April 28, 1996.

television, through its partnership with other cable and telecommunications companies. Sprint's CEO, William Esrey, recently announced construction of a packet-switched high bandwidth data network designed to carry voice, data and Internet traffic simultaneously on a single line.[37] This Integrated On-Demand Network ("ION") will be marketed to business and residential customers. Access to customers will use Broadband Metropolitan Area Networks which Sprint will deploy in close to 100 cities by the end of 1999 and XDSL technologies where Broadband Metropolitan networks are unavailable. In addition, Sprint focuses on wireless services, using its PCS network. In the PCS spectrum auction, Sprint paid $2.1 billion to win licenses in 29 markets. Sprint has also begun laying the foundation for its eventual bundled service offerings—telecommunications and cable—by offering cable discounts for customers who sign on with Sprint.

56. In sum, each of the three major IXCs is a more likely entrant into local exchange markets in Chicago than is SBC or in St. Louis than is Ameritech. They have experience, brand reputation, and local and long distance facilities in place along with existing customer relationships.

2. Competitive Access Providers

57. CAPs are CLECs with switches and optical fiber transport facilities that can be expanded to provide facilities-based local exchange service. Possessing facilities and a customer base, CAPs are more likely potential competitors for local exchange services than SBC or Ameritech. Most CAPs grew out of optical fiber metropolitan area networks where they supplied high capacity services to business customers in city centers and arbitraged carrier access charges. By March, 1995, CAPs had captured 10-15% of the national carrier access market, forcing SBC, Ameritech and other RBOCs to lower their access prices by 20-30% annually and improve the quality of their services.[38] With the addition of switches, CAPs have

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[37] "Sprint Unveils Revolutionary Network," PR Newswire, June 2, 1998.

[38] Bernstein Research, *Telecommunications: Convergence and Divergence*, March 1995.

made significant inroads into local exchange markets, particularly in the major urban areas. The largest and most successful CAPs have recently merged with other carriers to form full-service vertically integrated telecommunications suppliers.

58. TCG was the original CAP, and combined with AT&T, it has 90 local switches in SBC's region and 68 in Ameritech's region. By the time (January 1998) that AT&T announced its purchase of TCG for $11.3 billion, TCG was billing itself as the nation's largest competitive local exchange carrier.[39] AT&T-TCG has extensive fiber and collocation facilities across the SBC-Ameritech region, and the partnership appears to make the entities stronger and better poised as competitors to all other CLECs and ILECs.

59. MFS-WorldCom-Brooks Fiber has network facilities in nearly every state in SBC-Ameritech territory including—when combined with MCI—82 local switches in SBC's region and 33 in Ameritech's. On August 27, 1996 MFS was acquired by WorldCom to form what the New York Times described as the "nation's first fully integrated local and long-distance phone company since the breakup of the Bell System in 1984."[40] Subsequently, WorldCom has also acquired Brooks Fiber, another facilities-based local exchange provider and has proposed to merge with MCI. These acquisitions give both companies a competitive advantage relative to out-of-region ILECs with the combination of available facilities, a customer base and the MCI brand recognition.

60. Other CAPs of competitive significance include Intermedia Communications with multiple local switches in both St. Louis and Chicago, NEXTLINK and Mark Twain Communications which have multiple switches in Chicago and St. Louis respectively and approximately 10 additional CLECs which own switches in Chicago or St. Louis. Digital

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[39] "Wall Street Likes AT&T-Teleport, But TCG's Bell Rivals Attack Deal," Telecommunications Reports Daily, January 9, 1998.

[40] Mark Landler, "WorldCom to Buy MFS for $12 Billion, Creating a Phone Giant," *New York Times*, August 27, 1996 at D1.

Teleport maintains an extensive network in St. Louis (470 route miles with 76 buildings on-net), and 7 other CAPs[41] have networks planned or under construction in Chicago.

3. Cable Companies

61. Cable TV operators have used various strategies to provide local telephone service: (i) clustering, (ii) upgrading networks, (iii) branding, and (iv) packaging, particularly with high-speed Internet access services. . In the words of Time-Warner's president.

> Time Warner, like many of the other cable MSOs, has been purchasing, trading and joint venturing its cable systems in scores of markets across the country in order to consolidate assets and operations in more manageable geographic regions... These clusters will be the focus of our cable operations for years to come...[42]

As cable TV firms have clustered to achieve economies of scale, the number of major groupings in the SBC-Ameritech region has decreased. Cable suppliers such as Time Warner, Cox Communications, and Cable Lightpath are upgrading their networks and installing switches to supply traditional local exchange services to residential and business customers, packaging services with long distance supplied by IXCs, and supplying fast Internet access by cable modems. In SBC's region, Cox has installed 4 local switches, MediaOne has 9 and Time Warner has 4. In Ameritech's region, Time Warner has installed 4 switches. Time Warner and Cox have fiber networks in Ameritech and SBC territory, respectively. A number of companies have cable modem operators in SBC and Ameritech regions, including Cox Communications, GTE, MediaOne, Horizon Cable and Time Warner.

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[41] Allegiance Telecom, e.spire, MFN, MGC Communications, Teligent, and 21st Century Telecom.

[42] Prepared testimony of Richard D. Parsons, President, Time Warner, Inc., before the Senate Committee on the Judiciary Subcommittee on Antitrust, Business Rights and Competition, July 7, 1998.

62. TCI serves more than half of the cable subscribers in St. Louis and nearly 95 percent of the cable subscribers in the Chicago area.[43] The company is currently spending more than $1.8 billion to upgrade its cable network to improve service quality and to enable two-way capability for Internet and information services. Across the U.S., TCI connects to approximately 10 households in 100 and passes an additional 7 households.[44] In the SBC-Ameritech region, TCI passes 10.8 million homes and has 7.1 million subscribers served from 127,000 miles of coax and 2,900 miles of fiber.[45] Similarly Time Warner has built over 35 cable clusters of over 100,000 subscribers. Time Warner plans to upgrade 70 percent of its clusters in the next two years and invest over $4 billion in cable system infrastructure improvements.[46]

4. Internet Services

63. With the unprecedented growth in traffic on the Internet, demand for Internet access and for backbone capacity is growing far more rapidly than demand for other communications services. ILECs are relatively small participants in this market. There are estimated to be more than 4,500 ISPs in North America, of which the largest (by revenues) include MCI, UUNet Technologies, Netcom, AT&T and PSInet.[47] Similarly, RBOCs such as SBC and Ameritech do not operate the Internet backbone networks which are dominated by MCI-WorldCom, AT&T and Sprint.[48]

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[43] L. Rackl, "TCI takes Over in Local Cable Market: Purchase gives Firm 93 percent of Chicago Market," *Chicago Herald Daily*, April 18, 1998, at 1.

[44] Prepared Testimony of C. Michael Armstrong. Chairman and CEO, AT&T Corp. before the Senate Committee on Judiciary Antitrust, Business Rights and Competition Subcommittees, July 7, 1998.

[45] Claritas and Warren Publishing, *Cable System Database*, 1997.

[46] "Prepared Testimony of Richard D. Parsons, President, Time Warner, Before the Senate Committee on the Judiciary," Federal News Service, July 7, 1998.

[47] *Boardwatch Magazine, Directory of Internet Service* Providers, Winter 1998, at 5. *Computerworld*, May 20, 1996 at 68.

[48] The proposed MCI-WorldCom merger threatened to increase concentration in the supply of backbone Internet services, but recent indications are that MCI-WorldCom-MFS-Brooks (continued...)

64. Cable companies have been converting their networks to digital in order to provide high speed Internet services, and "data CLECs" such as Northpoint Communications and well-established CLECs such as TCG are providing digital subscriber line services to their customers. Though many ILECs provide Internet connections, they are not dominant suppliers, and there is robust competition in the ISP marketplace.

5. Summary

65. In comparison with other telecommunications suppliers in Chicago and St. Louis, SBC and Ameritech would have no unique advantage over other potential entrants in entering each other's local exchange market. Each currently possesses cellular facilities in the other's territory, but (i) neither firm clearly succeeded in reselling local exchange service to its cellular customers and (ii) in any case, rectifying the overlapping cellular licenses will ensure that an independent cellular provider will remain in each market so that potential competition from a cellular provider will not be diminished by the merger. Integrated IXCs such as AT&T-TCG-TCI, MCI-WorldCom-MFS-Brooks Fiber-UUNet and Sprint are certainly more likely entrants into Chicago and St. Louis local exchange markets than are SBC or Ameritech (respectively) since they have facilities, reputations, complete packages of services and customer relationships with every household in the region. Compared with wireless carriers, SBC and Ameritech have no necessary advantage in reselling ILEC local exchange service to their cellular customers, and, on the contrary, will be disadvantaged because they cannot supply interstate long distance services along with wireline local and wireless service. In short, where they lack facilities, a customer base and strong brand recognition, SBC and Ameritech would be less likely than IXCs, CAPs, cable companies or wireless suppliers to offer out-of-region local exchange service in each other's mass markets. In addition, absent the merger, SBC and Ameritech would be no more likely than any other ILEC to enter an out-of-region local exchange market.

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Fiber-UUNet will spin off MCI's wholesale and retail Internet services to Cable & Wireless as a condition of the merger in the EC and the US.

V. CONCLUSIONS

66. In our opinion, the proposed merger will produce a net benefit for consumers. There is no economic theory or scintilla of evidence to suggest that the merger poses any threat to actual or potential competition in local exchange, exchange access or long distance telecommunications markets. SBC and Ameritech do not currently compete in any market, and technological, legal and regulatory changes to those markets ensure that there are many actual and potential entrants into those markets better suited to compete with SBC than Ameritech and vice-versa.

67. On the contrary, the transaction would benefit competition and, ultimately, telecommunications customers by (i) encouraging facilities-based local exchange competition among ILECs initially to protect their large business customer base, and (ii) creating a more potent telecommunications competitor in domestic long distance markets, able to compete successfully with national and global multi-service, multi-technology firms. The merger would bring the benefits of increased facilities-based local exchange and long distance competition to consumers. It would expand the base of customers and services from which costs of research and development for new services are recovered and reduce other unit costs by eliminating overlap and redundancies. The higher return from research and development would stimulate a more rapid supply of new products and services. The merger would permit the combination of the best practices of both organizations to improve service quality. In net, the process of competition—both in local exchange and long distance markets—would be enhanced by the transaction and from that improvement, all consumers would necessarily benefit.